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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF LITCHFIELD PARK SERVICE COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS WASTEWATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	Docket No. SW-01428A-09-0103
IN THE MATTER OF THE APPLICATION OF LITCHFIELD PARK SERVICE COMPANY, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS WATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	Docket No. W-01427A-09-0104
IN THE MATTER OF THE APPLICATION OF LITCHFIELD PARK SERVICE COMPANY, AN ARIZONA CORPORATION, FOR AUTHORITY (1) TO ISSUE EVIDENCE OF INDEBTEDNESS IN AN AMOUNT NOT TO EXCEED $1,755,000 IN CONNECTION WITH (A) THE CONSTRUCTION OF TWO RECHARGE WELL INFRASTRUCTURE IMPROVEMENTS AND (2) TO ENCUMBER ITS REAL PROPERTY AND PLANT AS SECURITY FOR SUCH INDEBTEDNESS.	Docket No. W-01427A-09-0116
IN THE MATTER OF THE APPLICATION OF LITCHFIELD PARK SERVICE COMPANY, AN ARIZONA CORPORATION, FOR AUTHORITY (1) TO ISSUE EVIDENCE OF INDEBTEDNESS IN AN AMOUNT NOT TO EXCEED $1,170,000 IN CONNECTION WITH (A) THE CONSTRUCTION OF ONE 200 KW ROOF MOUNTED SOLAR GENERATOR INFRASTRUCTURE IMPROVEMENTS AND (2) TO ENCUMBER ITS REAL PROPERTY AND PLANT AS SECURITY FOR SUCH INDEBTEDNESS.	Docket No. W-01427A-09-0120

NOTICE OF FILING DIRECT TESTIMONY FOR PHASE 2

The Residential Utility Consumer Office ("RUCO") hereby submits this Notice of Filing the Direct Testimony of William A. Rigsby, CRRA, in the above-referenced matter.

RESPECTFULLY SUBMITTED this 6th day of June, 2011.

Michelle L. Wood
Counsel

AN ORIGINAL AND THIRTEEN COPIES
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of June, 2011 with:

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LITCHFIELD PARK SERVICE COMPANY
PHASE TWO

DOCKET NO. SW-01428A-09-0103 et al.

DIRECT TESTIMONY

OF

WILLIAM A. RIGSBY, CRRA

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

JUNE 6, 2011

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INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is William A. Rigsby. I am a Public Utilities Analyst V employed by the Residential Utility Consumer Office ("RUCO") located at 1110 W. Washington, Suite 220, Phoenix, Arizona 85007.

Q. Please state the purpose of your testimony.

A. The purpose of my testimony is to present RUCO's recommendations regarding a phased-in rates surcharge and a hook-up fee tariff being proposed by Litchfield Park Service Company ("LPSCO" or "Company") in Phase 2 of the Company's 2009 rate case proceeding.

Q. Did you file testimony and appear as an expert witness for RUCO in Phase 1 of this proceeding?

A. Yes. On November 4, 2009 I filed direct testimony with the Arizona Corporation Commission ("ACC" or "Commission") in Phase 1 of this proceeding. I also filed surrebuttal testimony on December 17, 2009 during Phase 1.

Q. How is your testimony organized?

A. My testimony contains four parts: the introduction that I have just presented; a brief background of the case; a section on the Company-proposed phased rates surcharge; and a section on the Company-proposed hook-up fee tariff.

BACKGROUND

Q. Briefly explain the background of this case.

A. On March 9, 2009, LPSCO, a subsidiary of Liberty Water, filed applications with the ACC seeking permanent rate increases for the Company's water and wastewater utility operations in Maricopa County. The evidentiary hearing on the matter began on January 4, 2009 and was concluded on January 15, 2010. During a Regular Open Meeting held on November 22, 2010, the five sitting ACC Commissioners voted to approve new rates, resulting in Decision No. 72026 which authorized a significant rate increase and adopted phased-in rates to mitigate the effects of rate shock on LPSCO's ratepayers. The Decision also established a second phase of the proceeding to deal with a surcharge to collect the foregone revenues associated with the aforementioned phase-in, and to deal with a proposed hook-up fee tariff for LPSCO's water division. On March 7, 2011, LPSCO filed a request to commence Phase 2 of the rate case. A procedural conference was held on May 2, 2011, which provided the parties to the case with an opportunity to discuss a procedural schedule for Phase 2 of the rate case proceeding. On May 11, 2011, LPSCO filed the direct testimony of Mr. Greg Sorenson. Mr. Sorenson's testimony presented the Company's proposed surcharge for collecting the foregone revenue associated with the phase-in, and LPSCO's proposed hook-up fee for the Company's water division.

PHASE-IN SURCHARGE

Q. Have you reviewed LPSCO's testimony on the Company-proposed phase-in surcharge?

A. Yes, I have reviewed Company witness Sorenson's testimony on the Company-proposed phase-in surcharge.

Q. Please describe the Company-proposed surcharge.

A. The Company is proposing a simple surcharge of 10.98 percent for water service and 8.46 percent for wastewater service to be applied against monthly bills. According to Mr. Sorenson, a residential water customer with a 5/8 x 3/4-inch meter and an average monthly bill of $16.37 would pay a monthly surcharge of $1.80. A residential wastewater customer with a monthly bill of $38.99 would pay monthly surcharge of $3.30. Based on the Company-proposed surcharge, the larger a customer's monthly bill is the more the customer will pay. The Company has designed the surcharge to collect the total amount of foregone revenue with interest over an eighteen-month period. If it takes less than eighteen months to recover the foregone revenue, LPSCO will terminate the Company-proposed surcharge early. If it takes longer than eighteen months, LPSCO will continue to apply the surcharge to its customers bills until the full amount of forgone revenue is collected.

Q. What rate of interest is LPSCO using?

A. LPSCO is using an interest rate of 7.72 percent which is the rate of return that was adopted in Decision No. 72026.

Q. Have you analyzed the Company-proposed surcharge?

A. Yes. I have had the opportunity to analyze the calculation of the Company-proposed surcharge. The dollar amounts presented by the Company are very close to what I calculated after Decision No. 72026 was issued.

Q. Does RUCO support the Company-proposed surcharge?

A. Yes. RUCO believes the Company-proposed surcharge will recover the forgone revenue as a result of the rate phase-in. RUCO also believes that the eighteen month recovery period is reasonable and mitigates the possibility of intergenerational inequities that can often result when customers choose to leave or connect to a water and wastewater system. An eighteen month time period is a reasonable amount of time to insure that those who were connected to the systems during the phase-in pay for their share of foregone revenues through the surcharge and those who were not on the system when the phase-in began pay as little extra as possible.

Q. What is RUCO's recommendation on the Company-proposed surcharge?

A. RUCO recommends that the Commission adopt the Company-proposed surcharge.

HOOK-UP FEE TARIFF

Q. Please describe LPSCO's hook-up fee tariff request.

A. LPSCO is requesting that the Commission approve a hook-up fee ("HUF") tariff for the Company's water division and that the Company's existing wastewater HUF be replaced with a new HUF that is identical in form to the aforementioned Company-proposed water HUF. According to Mr. Sorenson's testimony, LPSCO is requesting water HUFs based on meter size that start at $1,800 for a 5/8 x 3/4-inch meter and increase accordingly. For wastewater connections, the Company is proposing an HUF of $1,800 per Equivalent Residential Unit ("ERU") which is less than the current wastewater HUF of $2,450 per ERU. LPSCO is also asking that the Commission approve language in the water and wastewater HUF tariff's that will allow the Company to delay the recognition of amounts collected from HUFs for ratemaking purposes until the plant additions financed by them are placed into service. The Company-proposed language states that any funds collected from HUFs will not be deducted from rate base while they are sitting in a segregated bank account.

Q. In general, is RUCO opposed to the use of HUFs?

A. No. RUCO has supported the use of HUFs in the past.

Q. Does RUCO support the concept of an HUF in this case?

A. Yes.

Q. Is RUCO opposed to the HUF amounts being proposed by LPSCO?

A. No. RUCO's concern is with the language contained in the Company-proposed water and wastewater HUF tariffs.

Q. What is RUCO's main concern with the language contained in the Company-proposed water and wastewater HUF tariffs?

A. RUCO's main concern is that the language contained in the Company-proposed HUF tariffs allow LPSCO to delay the recognition of the HUF funds, which should have been booked as CIAC, as a deduction to rate base until the corresponding plant additions financed by the HUFs, are placed into service. With the exception of a recent case involving Liberty Water's Bella Vista Water Company, Inc. ("Bella Vista") subsidiary in Decision No. 72251, dated April 7, 2011, which I will discuss later in my testimony, this is a departure from the way in which CIAC has been treated for ratemaking purposes.

Q. Generally speaking, what is the purpose of HUFs?

A. Generally speaking, utilities, such as LPSCO, collect HUFs from third-party developers and use them to help cover the costs of off-site facilities for new service connections. This helps to shift risk away from the utility and its ratepayers and on to the third-party developers. Because the third-party developers are providing funds for infrastructure on new development – which may not generate future revenues – the utility's investor supplied capital is not placed at risk. Ratepayers also benefit from the collection of HUFs since they will not have to pay increased rates that would recover the costs for infrastructure that is intended for future customers – who may or may not connect to the system. This is because the HUFs are treated as non-refundable contributions-in-aid-of-construction ("CIAC") for ratemaking purposes.

Q. How are HUFs recognized on a utility's financial statements?

A. Because funds provided by HUFs represent non-investor supplied capital from third-party developers, they are typically recognized as CIAC on the liability side of a utility's balance sheet, as opposed to being recognized as revenue on a utility's income statement. At the time the funds are received, the utility will credit its CIAC account (a liability account) and debit its cash account (an asset account). Eventually the HUF funds in the cash account are used to finance the plant additions that they were intended for. The accounting procedure to recognize this would be to credit the cash account, on the asset side of the balance sheet, and to debit the utility plant in service account, which is also on the asset side of the balance sheet. Hence, the amount of new utility plant in service, recognized as an asset, is equal to the corresponding amounts that are recorded as CIAC, which are recognized as a liability. For ratemaking purposes the HUFs are recorded as CIAC, which represents non-investor supplied funds, and are treated as a deduction from rate base. Consequently, the utility does not earn any return on the plant additions funded by the HUFs and the utility does not recover the costs of the HUF-funded plant additions through depreciation expense. Furthermore, ratepayers will not have to pay for a return on and a return of the HUF-funded additions in their utility rates.

Q. How has CIAC been treated for ratemaking purposes in the past?

A. Typically CIAC balances recorded on a utility's books during a test year are treated as a deduction from rate base regardless of whether or not the plant additions associated with them have been constructed. This ratemaking treatment was applied to all CIAC funds whether they were collected through HUFs or not. Hook-up fees would be included in a utility's test year CIAC balance because the hook-up fee funds would have been booked by the utility as CIAC upon their receipt from developers.

Q. Why have CIAC funds, including those collected through HUFs, typically been treated as a deduction from rate base even if the associated plant additions have not been constructed?

A. There are public policy reasons as well as accounting reasons for requiring CIAC to be booked upon the receipt of funds. One reason is that the utility has the use of the funds during the time that the funds are collected and the time they are needed to finance the plant additions they were intended for.

Q. Is the deduction from rate base treatment for CIAC consistent with the treatment of other ratemaking elements?

A. Yes. This is true of advances-in-aid-of-construction ("AIAC") and accumulated deferred income taxes as well. In these cases, utilities also have the use of excess funds, collected from third-party developers in the case of AIAC, or from ratepayers in the case of accumulated deferred income taxes, which traditionally have been treated as deductions from rate base during a rate case proceeding.

…

Q. How has the National Association of Regulatory Utility Commissioners ("NARUC") defined CIAC in its Uniform System of Accounts ("USOA")?

A. The NARUC USOA defines CIAC as follows:

> "Any amount or item of money, services, or property received by a utility, from any person or governmental agency, any portion of which is provided at no cost to the utility, which represents an addition or transfer to the capital of the utility, and which is utilized to offset the acquisition, improvement or construction costs of the utility's property, facilities, or equipment used to provide utility services to the public."

Q. Do funds collected from HUFs meet this definition?

A. Yes.

Q. Would the Company still have use of the funds collected from HUFs even if they are sitting in a segregated bank account waiting to be used for one of the HUF's authorized uses?

A. Technically, yes. The Company could place the funds collected from HUFs into an interest bearing account and earn money on them while they are sitting idle. Because regulators would not know what the disposition of the funds are between rate case proceedings, it is not unreasonable to assume that the Company can move the funds collected from HUFs into other types of accounts or use them for other purposes, which is the precise reason why these types of funds have traditionally been treated as a deduction from rate base. So the fact that the funds may be in a segregated account during a test year doesn't mean that a utility couldn't use them for other purposes if chooses. As ACC Staff explains in its June

1, 2011 filing on the issue of unexpended HUFs in a different docket[1], "The unexpended CIAC are funds that can be used by the Company, thus the Company's rate base should be reduced by the CIAC. Reducing rate base by CIAC preserves the ratemaking balance and removes the possibility of the Company's earning an excess."

Q. What else does ACC Staff say in its recent June 1, 2011 filing on unexpended HUFs?

A. ACC Staff also says that CIAC should be booked in the CIAC account upon receipt. In its filing, ACC Staff recites the same NARUC USOA definition as I cited earlier in my testimony. ACC Staff correctly points out that, the characterization of hook-up fees (or CIAC) does not hinge upon whether the fees are spent but whether the funds were (i) provided by someone other than the Company's owner/investor; (ii) is non-refundable; and (iii) whether the purpose of the CIAC is to fund the plant. Further, the removal of unexpended CIAC from the CIAC account is inconsistent with the NARUC USOA."[2]

...

[1] Staff Response to Johnson Utilities Motion to Amend, Docket No. WS-02987A-08-0180, at 7

[2] Staff Response to Johnson Utilities Motion to Amend, Docket No. WS-02987A-08-0180, at pp.7-8

Q. Are there other problems associated with the Company-proposed tariff language?

A. Yes. Two problems come to mind. First, ACC Staff and other auditors would now have the added task of insuring that the HUF funds associated with plant additions have been properly recorded as a deduction from rate base during a rate case proceeding. If the auditors do "chase" the CIAC successfully, then it does not result in higher rates. However, even the most diligent of auditors may not be able to successfully track unrecorded CIAC. The second problem that comes to mind is that because utilities choose when to file for rates, it is possible that they would delay construction of HUF funded plant additions in order to avoid having to recognize the CIAC funded by HUFs as a deduction to rate base. Again, ratepayers are the losers under this scenario.

Q. Has the ACC approved similar HUF language in a prior Decision?

A. Yes. As I noted earlier in my testimony, the ACC adopted similar language for an HUF tariff that the Commission approved for Liberty Water's Bella Vista subsidiary.

Q. Does RUCO agree with the Commission's decision in the Bella Vista case?

A. No. RUCO believes that the Commission's adoption of the Company-proposed HUF tariff in the Bella Vista case was misguided. RUCO recommends that the Commission treat its decision in Bella Vista as a "test case" to see how well ACC Staff and the utility are able to properly identify and account for Bella Vista's hook-up fees that would not be treated as a deduction from rate base. RUCO believes that there is no harm to a utility from the traditional accounting and ratemaking treatment, given the fact that the sooner a utility places CIAC on its books, the sooner the utility can get CIAC off its books through the annual amortization process that reduces a utility's CIAC balance over time.

Q. What is RUCO's final recommendation regarding LPSCO's proposed HUF tariff language?

A. RUCO recommends that the Commission reject LPSCO's proposed HUF tariff language to the extent that it provides that 's are not deducted from rate base while they are sitting in a segregated bank account waiting to be used for one of the HUF's authorized uses.

Q. Does your silence on any of the issues or positions addressed in Mr. Sorenson's direct testimony constitute acceptance?

A. No, it does not.

Q. Does this conclude your direct testimony on Phase 2 of the LPSCO rate case proceeding?

A. Yes, it does.